



is a leading steel information service in Englewood Cliffs, N.J.

WSD's steel experience, steel database and availability of steel statistics are the principles for performing steel forecasts, studies and analysis for international clients. WSD seeks to understand how the "pricing power" of steel companies the world over will be impacted by changes in the steel industry's structure.

The views and opinions expressed in this article are solely those of World Steel Dynamics and not necessarily those of AIST.

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Fixed Asset Investment Contagion: Deteriorating Global FAI in 2014

Contagion, which is the spreading of unfavorable financial conditions in one part of the world to others, is growing like a virus because of the continuous stream of negative economic and political developments. In turn, since new fixed asset investment (FAI) projects are often based on confidence about the future, WSD thinks that FAI globally this year will probably decline as a share of global GDP. Consequently, WSD sees little possibility for a significant rise in steel demand in 2014 because FAI is the primary driver of global steel demand. WSD now expects that global steel production in 2014 will be little changed from 2013's 1.609 billion metric tons. Table 1 highlights the FAI/GDP ratio for several key countries.

The outlook for global FAI in 2014 has deteriorated. In fact, even before the recent crisis in Ukraine, the prospect for a sizable rise in FAI was low in WSD's opinion. Any slippage in FAI, of course, is a huge negative for steel demand, since it accounts for about 90% of Chinese steel demand and more than 80% elsewhere. The Fixed Asset Investment Flywheel may rotate no faster than in 2013 because the start-up of new projects may lag the pace at which the

backlog of existing products is worked off:

- In China, while reported FAI may rise 13–18% this year, including the value of land sales and M&A activity, it is likely that the rise in gross fixed capital formation (GFCF) will be far less, assuming: (a) some slowdown in residential construction activity, which accounts for 25% of the country's FAI; and (b) a fair portion of the recent sharp rise in renminbi (RMB)-based loans occurred based on the refinancing of existing municipalities' one-to-three-year loans.

On the political front, China's search for dominance of the South China Sea region, and the protection of its ocean-borne trade routes, could lead to economic disruption at any time.

- Outside of China, WSD thinks that contagion will add to political and economic uncertainty and reduce the confidence about the future that's so essential when new FAI commitments are made. Here are four examples:

Table 1

Key Economic Indicators (billion current US dollars unless otherwise specified)

	Brazil		India		Indonesia		Russia	
	Aug 2013	Mar 2014	Aug 2013	Mar 2014	Aug 2013	Mar 2014	Aug 2013	Mar 2014
Monthly indicators								
10-year bond yield	10.83%	12.78%	8.59%	8.90%	8.28%	8.11%	7.70%	8.72%
Currency	\$2.39	\$2.34	\$65.71	\$62.04	\$11,184	\$11,593	\$33.29	\$36.58
Stock market (YTD)	-8.7%		0.2%		7.7%		-17.9%	
2013 indicators								
GDP	\$2,190		\$1,758		\$867		\$2,118	
FAI	\$420		\$616		\$300		\$538	
FAI/GDP %	19.2%		35.0%		34.6%		25.4%	
Budget balance (% of GDP)	-3.3%		-3.1%		-3.3%		-0.5%	
Government debt (% of GDP)	68%		67%		26%		14%	
Current account balance	-\$74		-\$78		-\$30		\$61	
Inflation	6.2%		10.9%		7.0%		6.8%	
	S. Africa		Thailand		Turkey		Ukraine	
	Aug 2013	Mar 2014	Aug 2013	Mar 2014	Aug 2013	Mar 2014	Aug 2013	Mar 2014
Monthly indicators								
10-year bond yield	8.17%	8.58%	4.22%	8.63%	9.95%	10.36%	9.81%	10.19%
Currency	\$10.28	\$10.92	\$32.15	\$32.54	\$2.04	\$2.23	\$8.13	\$9.75
Stock market (YTD)	-5.8%		3.6%		-7.2%		25.6%	
2013 indicators								
GDP	\$354		\$401		\$822		\$176	
FAI	\$68		\$120		\$164		\$28	
FAI/GDP %	19.2%		30.0%		20.0%		16.2%	
Budget balance (% of GDP)	-4.8%		-3.1%		-1.2%		-4.4%	
Government debt (% of GDP)	43%		47%		36%		43%	
Current account balance	-\$21		\$0		-\$61		-\$13	
Inflation	5.7%		2.2%		7.5%		-0.3%	
	United States		Eurozone ¹		Japan		China	
	Aug 2013	Mar 2014	Aug 2013	Mar 2014	Aug 2013	Mar 2014	Aug 2013	Mar 2014
Monthly indicators								
10-year bond yield	2.78%	2.67%	1.86%	1.60%	0.71%	0.57%	3.98%	4.44%
Currency	—	—	\$1.32	\$1.37	\$98.17	\$102.17	\$6.12	\$6.14
Stock market (YTD)	1.1%		0.2%		-9.6%		-2.1%	
2013 indicators								
GDP	\$16,724		\$12,685		\$5,007		\$8,939	
FAI	\$3,240		\$2,270		\$1,035		\$4,370	
FAI/GDP %	19.4%		17.9%		20.7%		48.9%	
Budget balance (% of GDP)	-4.1%		—		-8.2%		—	
Government debt (% of GDP)	106%		96%		244%		23%	
Current account balance	-\$451		\$295		\$61		\$224	
Inflation	1.4%		1.3%		0.7%		3.0%	

¹Eurozone 10-year bond yield and stock market performance based on German figures. Source: Bloomberg, CEIC, IMF and Economist.

1. The political/economic/military crisis in Ukraine, including Russia's actions to prevent the new Ukrainian government from controlling the Crimean Peninsula, where Russia has a major all-weather Black Sea port and there's a preponderance of Russian-speaking people. The Ukrainian government may have a US\$35 billion shortage of funds at the present time.
2. The Arab Spring that has manifested itself in a wave of revolutionary demonstrations and protests to overthrow the existing order. Subsequently, like wildfire, protests have spread through much of the Arab world, including Egypt and Libya, where existing governments were ousted. Protests briefly flared up in Iran. In a number of countries, economic activity has been severely disrupted and FAI inhibited. The Arab Spring is still in force, as evidenced by the three-year civil war in Syria.
3. The lingering impact of 2010's eurozone sovereign debt crisis — a situation still stressful to many observers, even though the European Central

Bank has now stepped in with what, in effect, are loan guarantees. Nearly three years later, many of the EU "peripheral" countries have stretched finances, insufficient funds and no prospect for an immediate strong recovery in FAI.

4. The weakening of many non-Chinese developing world currencies in the past six months is impacting these countries' economic prospects and, at the same time, is dampening the enthusiasm to invest in these countries. Policymakers in a number of the countries have boosted interest rates in an attempt to protect their currency and combat inflation. Foreign direct investment may be reduced. On a home-currency basis, U.S. dollar-denominated debt obligations have risen because of the weakened currency. Overall, WSD thinks that much of the non-Chinese developing world economy is a "basket case" at the present time — with aggregated steel demand, at best, to rise only moderately in 2014.

Deciphering Steel's DNA: How to Better Anticipate the Next Wave of Chaotic Events

WSD's assumptions and clues:

1. The steel industry — and the global economy — is in an era of never-ending and unexpected chaos. One must count on a continuing array of unexpected events. No event is more threatening today than a continuing Russian/Ukrainian crisis. Yet, after the fact — i.e., looking back — there is usually almost irrefutable logic to explain why the unexpected event occurred. How might new forces at work and possible chaotic events be better anticipated?
2. When considering the invisible hand — i.e., price allocates resource — the observer must take into account:
 - The study of the human equation in the marketplace. How will people react to new marketplace conditions? As it has been learned over the years,

it's not uncommon to have a buyers' or a sellers' panic. The marketplace makes the shift from "hot" to "cold," or vice versa, almost overnight.

- The impact on supply and demand, near and longer term, as prices change.
- New events and conditions unfold rapidly, and frequently, because the Information Revolution — which stimulates the ongoing Technological Revolution — moves at warp speed. New conditions and changes in steel and other industry structure that, in the past took 5 to 10 years to work out, now occur in just a few years.

The early identification of unfolding new events and relationships is the "galvanized steel lunch pail" for the astute and proactive decision maker. The capturing of winning opportunities is no accident. ♦